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# POLITICS REINVENTED: ABE-KOIKE RIVALRY TO BRING SUPPLY-SIDE REFORMS

Jesper Koll – Senior Advisor  
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Japan's upcoming election is poised to usher in a new era of policy competition and political accountability. Structural reform in general, supply-side reform in particular, is poised to accelerate if, as we suspect, Tokyo Governor Yuriko Koike catapults herself into the never-imagined-before position of being both in power and in opposition: in power because she will continue to be the ruling governor of Tokyo and in opposition because she will be the leader of the second largest party in parliament (assuming current opinion polls are correct in their predictions). Given Governor Koike's long-standing credentials as a pro-business, pro-entrepreneur and pro-consumer-led-growth policy maker and the fact that Tokyo is Japan's most important economic region (accounting for slightly more than one-third of [gross domestic product \[GDP\]](#)), the post-election government will immediately come under attack for obstructing local growth initiatives and not delivering structural reform. It is this coming tension of national rules and regulations against local ambitions and "animal spirits" that is, in our view, the key dynamic to watch in Japanese politics and policy making from here.

Of course, it remains to be seen exactly how this new dynamic will play out. Here, the power balance in parliament will be important. The weaker the Liberal Democratic Party (LDP), the greater the supply-side reform ambitions will get. Note that Governor Koike's in-parliament party leader is likely to be the ex-leader of the Democratic Party, Seiji Maehara, who has impeccable deregulation credentials: As minister of transport in the first Democratic Party government, it was Maehara who opened Tokyo's Haneda Airport to international flights. He accomplished in a couple of weeks what LDP leaders had not been able to do for decades because of vested interest loyalties to Narita. Arguably, the Haneda opening was the start of Japan's reintegration with Asia and the world with enormous positive economic multipliers. The fact that both Koike and Maehara insisted on ousting old-style politicians and closet socialists from their party's merger bodes well for the coming supply-side agenda of the new opposition, in our view.

## What About Tax Hikes and Nuclear Power?

We are aware that the standard narrative on the election is more conservative. The media is trying hard to find comfort in familiar themes—Prime Minister Shinzo Abe is for the consumption tax hike and pro-nuclear, while Koike is against the tax hike and anti-nuclear. In our view, these policy differences are more symbolic of personal character than policy conviction. Abe is presented as a leader who went from challenging the powerful technocracy—he overruled against the previous tax hike—to an old-style LDP "insider"; Koike now takes his old place as challenger and outsider.

While there is nothing wrong with this narrative, we caution against taking the actual

policy platforms too literally. After all, the tax hike decision is due in December 2018, which leaves plenty of time to forget and/or reconsider. Already, Abe's chief cabinet spokesman suggested room for flexibility (depending on economic conditions at the time). Meanwhile, Koike's no-nukes stance is equally pragmatic—the phase-out goal is in far-off 2030. However, Japan has barely started to phase back in after the all-nukes-out stance post-Fukushima—five reactors have restarted, with 43 still idle; nuclear power accounts for less than 2% of all energy supply. So nothing radical here.

### Fiscal Dominance Trumps BOJ Governor

Similarly, we do not see a link between the election outcome and [monetary policy](#). This is because, in our view, Abe and Koike share the same deep-rooted pragmatism when it comes to macroeconomic policy making: In Japan, monetary and [fiscal policy](#) are seen as one and the same. “Fiscal dominance” has been working well. For most policy advisors, there appears no pressing reason to change back the previous policy models that insist on central bank independence. If at all, there is growing pride among Japanese politicians that Japan's “new monetary policy” is breaking ground for a new standard (see “Team Abe” having no qualms to push back the primary budget targets, as well as the latest Bank of Japan [BOJ] policy board vote, where the one dissenter advocated MORE easing).

In our view, the principle threat to Governor Kuroda's reappointment would be vocal opposition from Washington in general, the next Fed chair in particular. At this point, that seems an unlikely obstacle.

All said, we see the upcoming elections as an important inflection point for Japanese policy making. While macro policy stays put—fiscal dominance and BOJ zero yield curve control—a true supply-side pro-business, pro-deregulation and pro-growth agenda is poised to emerge as Team Abe's monopoly on power gets challenged and it is held accountable for more decisive action. The new force is the never-before-seen power of a united large parliamentary opposition led by the powerful governor of Tokyo, Japan's most important economic powerhouse, global financial center and showcase for the world.

### A Japan-First Coalition?

Now that the candidates have been announced, we still expect the LDP coalition to return with a stable majority of around 240 to 260 of the 465 seats, while Koike's Party of Hope becomes the largest opposition with 120–180 seats. Interestingly, Governor Koike has already opened the door for a potential coalition with the LDP. After all, Koike, Maehara and Abe do share a strong patriotic ideology that, in our view, goes back to the rallying cry of the Meiji-era elites who modernized Japan—“Fukoku Kyohei”: strong country, strong army. The bigger the loss of the LDP's current coalition partner Komeito, the greater the chances of a new “Japan First” collation between Abe's LDP and Koike's Party of Hope. In my view, I expect this scenario to become more likely after the next national elections, the mid-2019 upper house elections.

For now, the competition between Abe and Koike (i.e., between the central government establishment and the local Tokyo “disrupters”) is poised to deliver accelerated supply-side reform, in our view.

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**Gross domestic product (GDP)**: The sum total of all goods and services produced across an economy.

**Monetary policy**: Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

**Fiscal Policy**: Government spending policies that influence macroeconomic conditions. These policies affect tax rates, interest rates and government spending, in an effort to control the economy.